

IR35 OFF-PAYROLL WORKING RULES



IR35 OFF-PAYROLL WORKING RULES

Topics covered:

- When it applies
- Determining contractor employment status
- HRMC CEST Tool
- Status Determination Statement (SDS)
- Employment agencies

Off-payroll working rules

INTRODUCTION

Major changes took place in **April 2021** as businesses became responsible for deciding the employment status of the contractors they engage through the contractor's own limited company, known as a Personal Service Company or PSC.

Businesses will now assume PAYE liability on the payments it makes for the contractor's services – if it decides the contractor is really a 'disguised employee' rather than a genuinely independent contractor. These businesses will be known as the 'fee-payer'.

These changes - known as the **Off-Payroll Working Rules** and sometimes called **IR35** affect all medium to large private sector companies with a UK connection from 6 April 2021.

Many businesses have underestimated how much preparation is needed to be ready for these new rules.

WHEN DOES IT APPLY?

It applies to all payments made to contractors **on or after 6 April 2021** for services they have supplied personally on or after 6 April 2021.

If the services are provided before 6 April 2021 but payment is made afterwards, the payment is not affected by the new rules.

WHAT IS THE PURPOSE?

HMRC is trying to clamp down on tax avoidance. Owner-directors of limited companies enjoy various tax advantages over employees (such as paying themselves minimum salaries and the rest as dividends on profits).

The Government wants to ensure that people who are really working like employees but through their own limited PSC broadly pay the same tax and national insurance contributions (NICs) as people who are employed directly.

Under the current system the contractor's own PSC is responsible for deciding the employment status of the contractor it hires out to its business clients. If the contractor would be regarded as an employee if engaged directly by the client rather than engaged through their PSC, the IR35 rules say the contractor should be taxed as an employee. The contractor will be 'inside IR35', which means and pay tax and NICs.

The owner-director of the PSC making the decision about the contractor's deemed employment status, and the contractor themselves, are the same.

It is usually in the best interests of this individual to deem the working relationship with the client as not being akin to an employment relationship. That puts the contractor outside of the IR35 Rules, allowing them to retain the tax advantages of the genuinely self-employed contractor.

Under the current system there are also advantages to the business client in agreeing with the contractor's assessment that they are not a 'disguised employee'. For example, the business saves the 13.8% on the class 1 NICs it pays on an employee's salary and potentially on other employment related costs too.

ARE BUSINESSES MANIPULATING THE CURRENT SYSTEM?



In many cases, HMRC has estimated that there is around 80% non-compliance with the IR35 Rules in the private sector. That is why HMRC is now shifting responsibility for determining employment status to the end user medium and large business client.

Since IR35 came into effect in the public sector in 2017 HMRC have collected £millions more in tax and NICs.

WHAT IS THE DEFINITION OF A MEDIUM/LARGE BUSINESS?

HMRC applies the Companies Act 2006 definition of a medium or large company as meeting two of three tests:

1. Annual turnover of more than £10.2 million
2. Balance sheet total of more than £5.1 million
3. More than 50 employees.

Groups of companies are combined for this test.

HOW DOES THE CLIENT SET ABOUT DETERMINING CONTRACTOR EMPLOYMENT STATUS?

The place to start is by answering the questions on **HMRC's online CEST tool**.

CEST stands for 'Check Employment Status for Tax' and it was introduced in 2017 to help employers, workers and hirers determine how work being done should be determined for tax purposes.

CEST was updated in December 2020 so if you ran the test before then you may want to run it again.

HOW LONG DOES IT TAKE TO USE THE HRMC ONLINE CEST TOOL?

It only takes around ten minutes or so to complete CEST online in respect of each contractor and the result, in an estimated 80% of cases, will be given at the end.

However, HMRC warns that businesses must take 'all reasonable care' when assessing employment status.

The answers inputted into CEST must be a true reflection of the actual working relationship with the contractor and so some advance preparation time might be required.

This is especially so for businesses who may assign the task of running the CEST tool for many contractors it engages to one person or department (for example in procurement or accounts) who may not have the necessary knowledge of the true working relationship.

CAN BUSINESSES RELY ON CEST EMPLOYMENT STATUS DETERMINATION?

HMRC has stated that it will stand by its CEST determination unless it is found to be inaccurate or the results have been achieved through contrived arrangements designed to get a particular outcome. That would be treated as deliberate non-compliance which could attract penalties.

IF I USE HRMC'S CEST TOOL WILL HRMC COLLECT AND STORE THE DATA I HAVE ENTERED?

CEST is anonymous and HMRC say they will not store your data (but you should print out or screen shot your answers).

HOW SHOULD EMPLOYMENT STATUS BE DECIDED IF CEST DELIVERS AN UNDETERMINED RESULT?

This is probably one of the most challenging parts of the process and most businesses will want to involve their HR departments and/or legal advisers to help make the determination. There is no single straightforward test to determine whether someone is genuinely self-employed and in its official Employment Status Manual (ESM500) HMRC lists 13 separate indicators which should be taken into account.

Even the courts themselves remain resolutely non-committal. In the case of *Hall v Lorimer* the Court of Appeal warned against running through the list of indicators in a mechanical fashion, checking them off to see if they are present. Instead, the Court tells us that we must 'stand back from the detailed picture which has been painted and make an informed, considered and qualitative appreciation of the picture as a whole'.

Fortunately, there are some indicators which are usually more important than others, such as personal service, mutuality of obligation, substitution, control and financial risk. This is especially so when these factors are combined together.

For example, the facts that an individual has to provide personal service to the business client; cannot appoint a substitute to provide that service in their place; is subject to a large degree of control by the business, and does not bear any risk of real financial loss if the work they provide is substandard, all point to an employment situation. The opposite, and especially financial risk and substitution, suggests genuine self-employment.

WHAT IS THE NEXT STEP ONCE MADE A DECISION ABOUT CONTRACTOR EMPLOYMENT STATUS?

The business client must give a copy of their 'Status Determination Statement' (SDS) to the contractor and their PSC. Sometimes the contractor's services will be engaged via an agency. In that case the business client must give a copy of their SDS to the agency.

IS THERE A SET FORMAT FOR THE STATUS DETERMINATION STATEMENT?

No, there is no set format but the SDS must set out reasons for the business' decision. Where businesses want to rely on the outcome from the CEST tool they can send a copy of the questions and answers produced during the on-line test and this will qualify as a valid SDS.

IS THERE A DEADLINE TO SEND STATUS DETERMINATION STATEMENTS TO CONTRACTOR AND PSC(OR AGENCY)?

For existing contracts

The SDS must be issued before the first payment under the contract on or after 6 April 2021.

For new contracts

status should be determined before services are performed under the contract and, ideally, before the contract is signed. This is because the deemed employment status is likely to affect negotiation of the contract price.

WHAT HAPPENS IF A CONTRACTOR/PSC OBJECTS?

The business client **must respond within 45 days of the objection** either:

- Confirming its original determination and giving its reasons for doing so.
- Reversing its original decision, giving the date from which the new status determination applies and confirming that its previous SDS is withdrawn. *Allay (UK) Limited v Gehlen* UAEAT/003/20

IF AN EMPLOYMENT AGENCY IS INVOLVED - HOW DOES IT AFFECT THEM?

If an agency is part of the supply chain, providing the services of the contractor who has their own PSC, to the end user business client, - and the end user client has determined that the contractor is a deemed employee - the agency assumes liability for PAYE. The agency in this case becomes 'the fee payer'.

Once the client business and contractor have agreed the Status Determination Statement is that final, at least for the rest of the tax year? No. Each contract with the same contractor must be reviewed separately. That is because it is possible for the contractor to be providing services to client as a deemed employee but provide different services to the same client as a genuinely independent contractor.

WILL HRMC IMPOSE PENALTIES IF WE MAKE A MISTAKE?

HMRC has confirmed that, during the first year, it will not impose inaccuracy penalties unless there is deliberate non-compliance. It has also reiterated its pledge not to use information under the Off-Payroll Working Rules to open IR35 investigations for earlier years.

WILL IT GIVE THEM EMPLOYMENT RIGHTS AND BENEFITS?

No. The classification of a contractor as a deemed employee for tax purposes will not confer any employee rights on the individual. And the contractor's PSC -or agency if that is the intermediary - will remain responsible for the payment of benefits such as Statutory Sick Pay, Statutory Maternity or Paternity Pay and for the operation of pensions auto-enrolment.

WILL CONTRACTORS OBJECT TO BEING DENIED BENEFITS OF A 'REAL' EMPLOYEE?

Yes, indeed, some contractors may do exactly that. It could prompt a lot of future litigation, especially as there are differences in the legal tests used by HMRC and the employment tribunals when determining employee status and rights. Businesses may start to receive claims from contractors they have engaged for two or more years for employee claims such as unfair dismissal or redundancy pay.

If businesses and contractors are going to be renegotiating contracts in light of the Off-Payroll Working Rules over the next few months or years they may wish to take legal advice about any provisions that will point to employee status, such as those involving mutuality of obligation, substitution and control.



Deborah Scales

ASSOCIATE



View profile



deborah.scales@clarkslegal.com



020 7539 8029



For more information on how we can help your business: clarkslegal.com
email: contact@clarkslegal.com · Reading: [0118 958 5321](tel:01189585321) · London: [020 7539 8000](tel:02075398000)

Disclaimer: The content in this guide is for general information only. Please don't rely on it as legal or other professional advice.